

Message Text

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43

ACTION EB-11

INFO OCT-01 EUR-25 EA-11 ADP-00 L-03 H-02 CIAE-00 DODE-00

INR-10 NSAE-00 PA-03 RSC-01 USIA-12 PRS-01 FS-01

ABF-01 AID-20 COME-00 FRB-02 TRSE-00 XMB-07 OPIC-12

CIEP-02 LAB-06 SIL-01 OMB-01 NSC-10 SS-14 STR-08

CEA-02 RSR-01 /168 W

----- 084532

R 021607 Z APR 73

FM AMEMBASSY ROME

TO SECSTATE WASHDC 8081

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

USMISSION EC BRUSSELS UNN

TUESGPQ/ AMEMBASSY THE HAGUE 2437

AMEMBASSY LONDON

AMEMBASSY OTTAWA

AMEMBASSY PARIS

USMISSION OECD PARIS UNN

AMEMBASSY STOCKHOLM

AMEMBASSY TOKYO

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E. O. 11652: N/ A

TAGS: EFIN IT

SUBJECT: ITALIAN EXCHANGE MARKET DEVELOPMENTS

1. SUMMARY: DESPITE SOME SUPPORT FROM BANK OF ITALY COMMERCIAL LIRA RATE MARCH 30 NEARLY REACHED OLD SMITHSONIAN PARITY. HOWEVER, BOI BELIEVES THAT LIRA SHOULD STRENGTHEN SOMEWHAT IN COMING MONTHS. END SUMMARY.

2. ON MARCH 30 HEAD OF FOREIGN DEPARTMENT OF BANK OF ITALY, ERCOLANI, SAID THAT BANK HAD BEEN PURCHASING LIRE IN EXCHANGE
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MARKET DURING RECENT DAYS IN ORDER TO CUSHION DECLINE OF COMMERCIAL LIRA. MARKET OPERATORS HAD BEEN CONVINCED THAT LIRA WAS BASICALLY WEAK AND EVENTUALLY WOULD FALL BACK TO SMITHSONIAN CENTRAL RATE. THIS HAPPENED ON MARCH 30, WHEN AVERAGE COMMERCIAL RATE FOR ROME AND MILAN WAS 581.43.

3. ERCOLANI ADMITTED THAT, PREVIOUSLY, BANK HAD BEEN INTERVENING IN OPPOSITE DIRECTION IN ORDER TO RECOUP PREVIOUS DOLLAR LOSSES. PROVISIONAL FOREIGN EXCHANGE DATA FOR MONTH OF FEBRUARY SHOW GLOBAL SURPLUS OF \$187 MILLION COMPARED TO \$697 MILLION DEFICIT IN JANUARY. THUS, OVERALL DEFICIT FOR FIRST TWO MONTHS OF 1973 WAS \$510 MILLION.

4. DURING FIRST TWO MONTHS OF YEAR ITALIAN BORROWING UNDER INTRA-EC VERY SHORT- TERM CREDIT LINES (WHILE COMMERCIAL LIRA WAS STILL PART OF EC SNAKE) AMOUNTED TO \$292 MILLION, OF WHICH \$262 MILLION WAS OWED TO BELGIAN NATIONAL BANK AND \$30 MILLION TO DANISH NATIONAL BANK. DURING SAME PERIOD EURO- DOLLAR BORROWINGS BY IMI (AND PERHAPS OTHERS) TOTALLED NEARLY 350 MILLION. UNDERSTAND THAT AT LEAST \$200 MILLION OF THIS, WHICH HAD BEEN BORROWED FROM JAPANESE BANKS, WAS USED TO MAKE REPAYMENTS ON 1972 IMI BORROWINGS IN EURO MARKET.

5. ITALIAN EXCHANGE OFFICE HAS ASKED COMMERCIAL BANKS TO ROLL OVER " REVERSE" SWAPS FOR ADDITIONAL THREE MONTH PERIOD. REVERSE SWAP ARRANGEMENTS WERE INTRODUCED IN DECEMBER 1972 IN ORDER TO ENCOURAGE BANKS TO BORROW ABROAD AND TO SELL FOREIGN CURRENCY TO ITALIAN EXCHANGE OFFICE (UIC). SINCE PRESENT INTEREST RATES ABROAD ARE HIGHER THAN IN ITALY, UIC HAS AGREED TO PAY PREMIUM ON SWAPS WHICH ARE EXTENDED FOR ADDITIONAL THREE MONTHS. ITALIAN AUTHORITIES WOULD NOT WISH OFFICIAL RESERVES TO DECLINE PRECIPITOUSLY AS RESULT OF LARGE REPAYMENT OF THESE FOREIGN BORROWINGS. AMOUNT OF THESE SWAPS OUTSTANDING NOW BELIEVED TO BE ABOUT \$750 MILLION.

6. ERCOLANI CONTINUED TO BELIEVE THAT COMMERCIAL LIRA WAS STRONGER THAN CURRENT MARKET QUOTATIONS INDICATE AND THAT IT WOULD STRENGTHEN IN NEXT FEW MONTHS, E. G., MAY OR JUNE, WHEN HE EXPECTED VERY LARGE ADVERSE LEADS AND LAGS FROM 1972 TO REVERSE THEMSELVES. ALSO LIRA SHOULD BECOME STRONGER SEASONALLY DUE TO TOURISM.

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7. COMMENT: ALTHOUGH WE EXPECT ITALIAN CURRENT ACCOUNT SURPLUS

TO DECLINE DURING 1973, WE ARE SURPRISED AT RECENT WEAKNESSES OF COMMERCIAL LIRA. (FINANCIAL LIRA MARKET IS VERY THIN AND SUBJECT TO RATHER VOLATILE MOVEMENTS.) DECLINE IN COMMERCIAL RATE MUST BE EXPLAINED MAINLY BY NEGATIVE PSYCHOLOGY OF MARKET. CONFIDENCE DOES NOT SEEM TO HAVE BEEN RESTORED AND EXPORTERS AND IMPORTERS ARE APPARENTLY STILL DEFENDING THEMSELVES AGAINST FURTHER LIRA DEVALUATION BY TAKING ADVANTAGE OF LEADS AND LAGS TO EXTENT STILL PERMITTED UNDER NEW TIGHTER EXCHANGE CONTROLS. MAGNITUDE OF ITALIAN EXCHANGE LOSSES IN JANUARY OF NEARLY \$700 MILLION, WHICH IS ALL- TIME HIGH, IS ONLY JUST BECOMING PUBLIC KNOWLEDGE. THIS SHOULD HELP TO PERSUADE DOUBTERS OF SERIOUSNESS OF FOREIGN EXCHANGE SITUATION WHICH LED TO CREATION OF DUAL MARKET AND EVENTUALLY TO FLOATING OF BOTH FINANCIAL AND COMMERCIAL LIRE. COMMERCIAL LIRA HAS NOW FALLEN TO SMITHSONIAN LEVEL, THUS NEGATING DOLLAR DEVALUATION. QUESTION ARISES WHETHER COMMERCIAL LIRA WILL STABILIZE AROUND THIS LEVEL OR WHETHER IT WILL CONTINUE TO DECLINE.

8. IT INTERESTING TO SEE THAT BOI HAS INTERVENED IN BOTH DIRECTIONS, IN RCENT WEEKS, FIRST TO PURCHASE FOREIGN EXCHANGE IN ORDER TO REBUILD RESERVES AND THEN TO CUSHION DECLINE OF LIRE. OVER COMING MONTHS ADVERSE LEADS AND LAGS, WHICH MAY HAVE BEEN IN EXCESS OF \$2 BILLION IN 1972, SHOULD REVERSE THEMSELVES. ON OTHER HAND, AUTHORITIES WILL WISH TO AMMORTIZE AT LEAST PART OF VERY LARGE 1972 BORROWINGS OF STATE ENTITIES WHICH EXCEEDED \$1 BILLION AND OF COMMERCIAL BANKS WHICH EXCEEDED \$500 MILLION. DECON 12/31/74. VOLPE

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